

ENCOMPASS INSURANCE COMPANY OF AMERICA

**CNA Center
Chicago, Illinois 60685**

NAIC COMPANY CODE 10071

**MARKET CONDUCT EXAMINATION REPORT
as of December 31, 2004**

**PREPARED BY INDEPENDENT CONTRACTORS FOR THE
COLORADO DEPARTMENT OF REGULATORY AGENCIES
DIVISION OF INSURANCE**

ENCOMPASS INSURANCE COMPANY OF AMERICA

**CNA Center
Chicago, Illinois 60685**

**MARKET CONDUCT
EXAMINATION REPORT**

**as of
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Prepared by

James T. Axman, CIE

Frederick T. Verny, Jr., AIE, FLMI

Independent Contract Examiners

July 7, 2005

The Honorable David F. Rivera
Commissioner of Insurance
State of Colorado
1560 Broadway Suite 850
Denver, Colorado 80202

Commissioner Rivera:

In accordance with §§ 10-1-203 and 10-3-1106, C.R.S., a limited Market Conduct examination of the private passenger automobile and homeowners business practices of ENCOMPASS INSURANCE COMPANY OF AMERICA has been conducted.

The Company's underwriting records were examined at its Home Office, 401 Penn Street, Reading, PA 19601. The Company's claim records were examined at the following regional offices, 4100 Midway Rd, Carrollton, TX, 75007 and 10995 Gold Center Drive, Suite 200, Rancho Cordova, CA 95670.

The examination covered the period from July 1, 2003 to December 31, 2004.

A report of the examination of ENCOMPASS INSURANCE COMPANY OF AMERICA is, herewith, respectfully submitted.

James T. Axman, CIE

Frederick T. Verny, Jr., AIE, FLMI

Independent Market Conduct Examiners

**MARKET CONDUCT
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OF
ENCOMPASS INSURANCE COMPANY OF AMERICA**

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COMPANY PROFILE

CNAF is a holding company whose subsidiaries consist primarily of property/casualty companies, as well as some group health. The CNA Companies collectively are the eleventh largest writers of commercial property/casualty insurance, and one of the largest insurance organizations in the United States. CNAF had assets of approximately \$62.5 billion and stockholders' equity of approximately \$9.2 billion as of December 31, 2004. CNAF's common stock is listed on the New York Stock Exchange, the Chicago Stock Exchange and the Pacific Exchange and also traded on the Philadelphia Stock Exchange. The trading symbol for the Common Stock is "CNA". As of December 31, 2004, Loews Corporation owned approximately 91% of CNAF's outstanding common stock, and 100% of series H preferred stock. CNAF's principal subsidiaries are Continental Casualty Company ("CCC"), incorporated in 1911, and the Continental Corporation ("Continental"), which is the holding company of the Continental Insurance Company ("CIC"), incorporated in 1853. All underwriting company subsidiaries are part of one of these pools.

The principal business of the CNA Companies is insurance. CCC, CIC and each of their property and casualty insurance affiliates generally conduct the property and casualty insurance operations of the CNA Companies. CAC and CCC generally conduct commercial property and casualty operations of the CNA Companies. The principal market for insurance products offered by the CNA Company is the United States.

*As of the calendar year 2003 the Company had reported premium in Colorado of \$8,720,000 for Private Passenger Automobile Insurance, representing a .30 % market share. The Company reported premium in Colorado of \$4,088,000 for Homeowners Insurance, representing a .41 % market share.

*Data as reported in the 2003 Colorado Insurance Industry Statistical report.

PURPOSE AND SCOPE OF EXAMINATION

This market conduct report was prepared by independent examiners contracting with the Colorado Division of Insurance for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the State of Colorado. This procedure is in accordance with Colorado Insurance Law §10-1-204, C.R.S., which empowers the Commissioner to supplement his resources to conduct market conduct examinations. The findings in this report, including all work product developed in the production of this report, are the sole property of the Colorado Division of Insurance.

The purpose of the examination was to determine the Company's compliance with Colorado insurance law and with generally accepted operating principles related to Private Passenger Automobile insurance laws. Examination information contained in this report should serve only these purposes. The conclusions and findings of this examination are public record. The preceding statements are not intended to limit or restrict the distribution of this report.

This examination was governed by, and performed in accordance with, procedures developed by the National Association of Insurance Commissioners and the Colorado Division of Insurance. In reviewing material for this report the examiners relied primarily on records and material maintained by the Company. The examination covered a seventeen (17) month period of the Company's operations, from July 1, 2003 to December 31, 2004.

File sampling was based on a review of underwriting and claims files that were systematically selected by using ACLTM software and computer data files provided by the company. Sample sizes were chosen based on procedures developed by the National Association of Insurance Commissioners. Upon review of each file any concerns or discrepancies were noted on comment forms and delivered to the Company for review. Once the Company was advised of a finding contained in a comment form, the Company had the opportunity to respond. For each finding the Company was requested to agree, disagree or otherwise justify the Company's noted action. At the conclusion of each sample the Company was provided a summary of the findings for that sample. The examination report is a report by exception. Therefore, much of the material reviewed is not addressed in this written report. Reference to any practices, procedures, or files, which manifested no improprieties, was omitted.

An error tolerance level of plus or minus ten dollars (\$10.00) was allowed in most cases where monetary values were involved. However, in cases where monetary values were generated by computer or other systemic methodology, a zero (\$0) tolerance level was applied in order to identify possible system errors. Additionally, a zero (\$0) tolerance level was applied in instances where there appeared to be a consistent pattern of deviation from the Company's established policies, procedures, rules and/or guidelines.

When sampling was involved, a minimum error tolerance level of five percent (5%) was established to determine reportable exceptions. However, if an issue appeared to be systemic, or when due to the sampling process it was not feasible to establish an exception percentage, a minimum error tolerance percentage was not utilized. Also, if more than one sample was reviewed in a particular area of the examination (e.g. timeliness of claims payment), and if one or more of the samples yielded an exception rate of five percent (5%) or more, the results of any other samples with exception percentages less than five percent (5%) were also included.

The report addresses Private Passenger Automobile (there were no Homeowners issues found) and contains information regarding exceptions to Colorado insurance law. The examination included review of the following:

1. Company Operations and Management
2. Complaints
3. Underwriting
4. Rating
5. Claims Practices

Certain unacceptable or non-complying practices may not have been discovered in the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Commissioner. Failure to identify or criticize specific Company practices does not constitute acceptance by the Colorado Division of Insurance. Examination findings may result in administrative action by the Division of Insurance.

EXAMINERS' METHODOLOGY

The examiners reviewed the Company's Private Passenger Automobile underwriting, rating, and claims practices to determine compliance with the Colorado insurance law as outlined in Exhibit 1.

Exhibit 1

Law	Subject
Section 10-1-128	Fraudulent Insurance Acts.
Section 10-4-413	Records required to be maintained
Section 10-4-602	Basis for Cancellation.
Section 10-4-603	Notice.
Section 10-4-604	Nonrenewal.
Section 10-4-605	Proof of notice.
Section 10-4-609	Insurance protection against uninsured motorists-applicability.
Section 10-4-610	Property damage protection against uninsured motorists.
Section 10-4-611	Elimination of discounts – damage by uninsured motorist.
Section 10-4-613	Glass repair and replacement.
Section 10-4-614	Inflatable restraint systems - replacement - verification of claims.
Section 10-4-626	Prohibited reasons for nonrenewal or refusal to write auto
Section 10-4-627	Discriminatory standards-proof of financial responsibility
Section 10-4-628	Refusal to write – changes in – cancellation-nonrenewal prohibited
Section 10-4-629	Cancellation-renewal-reclassification
Section 10-4-630	Exclusion of named driver
Section 10-4-632	Reduction in rates for drivers aged 55 or older with drivers education
Section 10-4-633	Certification of policy and notice forms
Section 10-3-1103	Unfair methods of competition and unfair or deceptive acts or practices prohibited.
Section 10-3-1104	Unfair methods of competition and unfair or deceptive acts or practices prohibited.
Regulation 1-1-7	Market Conduct Record Retention.
Regulation 1-1-8	Penalties And Timelines Concerning Division Inquiries And Document Requests
Regulation 5-1-2	Application and Binder Forms.
Regulation 5-1-10	Rate and Rule Filing Regulation
Regulation 5-1-16	Limitations on the Use of Credit Information or Insurance Scoring.
Regulation 5-2-1	Relative Value Schedule for No Fault.
Regulation 5-2-2	Renewal of Automobile Insurance Policies – Excluded Named Driver
Regulation 5-2-3	Amended Auto Accident Reparations Act (No Fault) Rules and Regulations
Regulation 5-2-6	Automobile No Fault Cost Containment Options.
Regulation 5-2-8	Timely Payment of Personal Protection Benefits.
Regulation 5-2-9	Personal Injury Protection Examination Program.
Regulation 5-2-11	Transition from No-Fault Auto to Tort System.
Regulation 5-2-12	Automobile Insurance Consumer Protections.
Regulation 6-1-1	Limiting coverage.
Regulation 6-2-1	Complaint Record Maintenance.

Company Operations/Management

The examiners reviewed Company management, implementation, and quality controls, record retention, installment payment plans, anti-fraud plan, forms certification, and timely cooperation with the examination process.

Complaints

The examiners reviewed the complaint database log maintained by the Division of Insurance as a general guideline to determine complaint activity for the period under examination.

Contract Forms and Endorsements

The following Private Passenger Automobile forms and endorsements were filed for certification with the Colorado Division of Insurance on September 08, 2004: These forms were also reviewed to determine compliance with the Colorado law.

Title	Form
Suspension of Insurance	G-15096-C (05/01)
Reinstatement of Insurance	G-15109-B (01/93)
CSL Liability	G-15335-C (09/93)
Front Contract Cover	G-18126-A
Back Contract Cover	G-18127-A
Motor Vehicle	G-18536-A (09/93)
Special Motor Vehicle	G-18538-A (09/93)
Introduction	G-18538-A (09/93)
General Provisions	G-18540-A (09/93)
Personal Umbrella Coverage Endorsement	G1-70613-A (06/03)
Auto Electric Equipment	G-18686-A (09/93)
Auto Loan/Lease	G-18687-B (12/94)
Motorhome Additional Coverages	G-18698-A (09/93)
Uninsured/Underinsured Motorists-CSL	G-18731-C (04/98)
Extended Non-Owned Auto Coverage Endorsement	G-18951-B (04/94)
Uninsured Motorist Property Damage Colorado	G-18989-B (11/98)
Amendment of Motor Vehicle Provisions-CO	G-18990-F (01/03)
Uninsured/Underinsured Motorists Coverage- CO	G-19304-C (04/98)
Policy Index	G19335-C (09/93)
Amendment of General Policy Provisions	G-19363-D (05/98)
Colorado Private Passenger Automobile Insurance Disclosure	G-20449-D (05/03)
Repair/Replacement Coverage	G42314-C (09/93)
Named Driver Exclusion Endorsement	G-42366-C (01/93)
Motor Vehicle Stated Amount	G55299-F (09/93)
Colorado Auto Insurance Identification Card	G-56910-C
Special Automobile Transition Endorsement	GI-15376-A (06/95)
Deluxe Automobile Transition Endorsement	GI-15377-A (06/93)

Elite Automobile Transition Endorsement	GI-15378-A (06/95)
Rental Car Coverage Notice	923210E (04/00)
Deletion of Towing	GI-32336-A (07/98)
Deletion of Transportation-Special	GI-32337-A (07/98)
Towing Coverage	GI-32346-A (07/98)
Transportation Coverage-Special	GI-32347-A (07/98)
Extended Transportation Coverage-Special	GI-32348-A (07/98)
Important Information About Changes to Your Motor Vehicle Coverage	GI-70807-A (05/03)
Colorado Consent to Remove Personal Injury Protection Coverage	GI-70808-A (05/03)
Automobile Ins. Identification Card (with PIP referenced removed.)	ACCORD 50 (01/83)
Colorado Personal Auto Application (with PIP removed.)	ACCORD 90 (2003-07)
Cancel-Nonpayment	PC9674041424301CO41998 (04/98)
Package Cancel-Nonpayment	PC9697404142430111CO52001 (05/01)
Cancel-Temporary Nonpayment	PC24252627CO51996 (05/96)
Cancel-Exclude Driver	PC961213142117024041424301CO41998 (04/98)
Package Cancel-Exclude Driver	PC96121314211702404142430111CO52001.(05/01)
Cancel –Other Reasons	PC9697404142430102CO41998.(04/98)
Package Cancel-Other Reasons	PC969740414243010211CO52001 (05/01)
Conditional Renewal-Increase in Premium	PR972903212804404142431002CO32004 (03/04)
Conditional Renewal-Reduction in Coverage	PR9705062221404142431002CO41998 (04/98)
Conditional Renewal-Increase in Premium Exclude Driver	PR972903212804191813141617404142431002CO32004 (03/04)
Conditional Renewal-Other Reasons	PR972221404142431002CO41998 (04/98)
Non-renewal-Nonpayment	PN9697CO51995
Non-renewal-Exclusion of Driver	PN961213142117024041424301CO41998 (04/98)
Non-renewal-Other Reasons	PN9697404142430102CO41998 (04/98)
Policy Change-Other Reasons	PP9697CO51995 (05/95)

Package Policy Change	PP9697CO51995 (05/95)
Renewal Premium	PE97212099CO51995 (05/95)

Private Passenger Automobile Cancellations/Non-renewals/Surcharges/PIP Conversion/Renewals

For the period under examination, systematically selected samples were taken as follows:

Review Lists	Population	Sample Size	Percentage to Population
Renewals	3820	50	1.3%
Cancellations	1403	50	4%
Nonrenewals	82	50	61%
Surcharges	264	50	19%
PIP Conversion	654	50	8%

Homeowners Cancellations and Non-renewals

For the period under examination, systematically selected samples were taken as follows:

Review Lists	Population	Sample Size	Percentage to Population
Cancellations	818	50	6%
Nonrenewals	84	50	60%

Rating

The examiners reviewed the rate, rule filings, statistical justifications, and methodology submitted to the Colorado Division of Insurance for the period under examination. This information was compared against a sample of in-force policies, rated by coverage selection, to determine compliance with filed base rates, territory codes, symbols, class plans, discounts, tier-rating factors, and final premium calculations.

Claims

For the period under examination, the examiners systematically selected the following samples to determine compliance with claims handling practices and manual rules:

Review Lists	Population	Sample Size	Percentage to Population
Auto Claims Paid	1156	50	4%
Auto Claims Paid - PIP	6	50	12%
Auto Claims - CWP	813	50	6%
Homeowners Claims Paid	661	50	8%
Homeowners Claims - CWP	138	50	36%

EXAMINATION REPORT SUMMARY

The examination resulted in three (3) issues arising from the Company's apparent failure to comply with Colorado insurance laws that govern all property and casualty insurers operating in Colorado.

Company Operations and Management:

In the area of company operations and management two (2) compliance issues are addressed in this report: The issues in this phase are identified as follows:

- **Failure, in some cases, to provide all surcharge notices requested in order to facilitate the review of surcharged policies.**
- **Delay in submitting the 2004 annual certification of forms to the Division of Insurance**

It is recommended that the Company review its company operations practices and procedures and make necessary changes to ensure future compliance with applicable statutes and regulations.

Complaint Handling:

In the area of complaint handling, no compliance issues are addressed in this report.

Underwriting:

In the area of underwriting, no issues are addressed in this report.

Rating:

In the area of rating, no compliance issues are addressed in this report

Claim Practices:

In the area of claim practices, one (1) compliance issue is addressed in this report. Issues arise from Colorado insurance law requirements dealing with the fair and equitable settlements, claims handling practices, payment of PIP claim benefits, and the timeliness and accuracy of claim payments. The issue in this phase was identified as follows:

- **Failure, in some cases, to handle Private Passenger Automobile claims properly.**

It is recommended that the Company review its claim handling practices and procedures and make necessary changes to ensure future compliance with applicable statutes and regulations as to the issue addressed.

A copy of the Company's response, if applicable, can be obtained by contacting the Company or the Colorado Division of Insurance.

Results of previous Market Conduct Exams are available on the Colorado Division of Insurance's website at www.dora.state.co.us/insurance or by contacting the Colorado Division of Insurance.

ENCOMPASS INSURANCE COMPANY OF AMERICA

PERTINENT FACTUAL FINDINGS

COMPANY OPERATIONS AND MANAGEMENT

Issue A: Failure, in some cases, to provide all surcharge notices requested in order to facilitate the review of surcharged policies.

Section 10-4-413, C.R.S. Records required to be maintained.

(1) Every insurer, rating organization, or advisory organization and every group, association, or other organization of insurers which engages in joint underwriting or joint reinsurance shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience or the experience of its members and of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules, policy or bond forms, surveys, or inspections made or used by it, so that such records will be available at all reasonable times to enable the commissioner to determine whether such organization, insurer, group, or association and, in the case of an insurer or rating organization, every rate, rating plan, and rating system made or used by it complies with the provisions of this part 4 applicable to it. The maintenance of such records in the office of a licensed rating organization of which an insurer is a member or subscriber will be sufficient compliance with this section for any insurer maintaining membership or subscribership in such organization to the extent that the insurer uses the rates, rating plans, rating systems, or underwriting rules of such organization. Such records shall be maintained in an office within this state or shall be made available for examination or inspection by the commissioner at any time, upon reasonable notice.

Additionally, Colorado Regulation 1-1-7, promulgated under the authority of Section 10-1-109, C.R.S. states in part:

B. RECORDS REQUIRED FOR MARKET CONDUCT PURPOSES

1. Every insurer/carrier or related entity licensed to do business in this state shall maintain its books, records, documents and other business records so that the insurer's/carrier's or related entity's claims, rating, underwriting, marketing, complaint, and producer licensing records are readily available to the commissioner. Unless otherwise stated within this regulation, records shall be maintained for the current calendar year plus two calendar years.

2. A policy record shall be maintained for each policy issued in this state. Policy records shall be maintained for the current policy term, plus two calendar years, unless otherwise contractually required to be retained for a longer period. Provided, however, documents from policy records no longer required to be maintained under this regulation, which are used to rate or underwrite a current policy, must be maintained in the current policy records. Policy records shall be maintained so as to show clearly the policy term, basis for rating and, if terminated, return premium amounts, if any. Policy records need not be segregated from the policy records of other states so long as they are readily available to the commissioner as required under this rule. A separate copy need not be maintained in the individual policy records, provided that any data relating to that policy can be retrieved. Policy records shall include:

- a. the application for each policy, if any;
- b. Declaration pages, endorsements, riders, termination notices, guidelines or manuals associated with or used for the rating or underwriting of the policy. Binder(s) shall be retained if a policy was not issued; and
- c. Other information necessary for reconstruction of the rating and underwriting of the policy...

The Company could not provide eight (8) notifications of increase in premium for review.

Recommendation # 1:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Section 10-4-413, C.R.S., and Colorado Regulation 1-1-7. In the event the Company is unable to provide such documentation, it should be required to provide evidence to the Division of Insurance that it has reviewed its procedure for record maintenance and implemented necessary procedural changes in order to ensure compliance with Colorado insurance law.

Issue B: Delay in submitting the 2004 annual certification of forms to the Division of Insurance.

Section 10-4-633, C.R.S. Certification of policy and notice forms.

(1) All insurers providing automobile insurance and who are authorized by the commissioner to conduct business in Colorado shall submit an annual report to the commissioner listing any policy forms, endorsements, cancellation notices, renewal notices, disclosure forms, notices of proposed premium increases, notices of proposed reductions in coverage, and such other forms as may be requested by the commissioner issued or delivered to any policyholder in Colorado. Such listing shall be submitted no later than July 1 of each year and shall contain a certification by an officer of the organization that to the best of the officer's knowledge each policy form, endorsement, or notice form in use complies with Colorado law. The necessary elements of the certification shall be determined by the commissioner.

Company records indicate that the 2004 certification was signed by a corporate officer on August 20, 2004, and stamped "filed" by the Division of Insurance on September 9, 2004. This represents an approximate two (2) month delay in order to be in compliance with Colorado insurance law. Section 10-4-633 as set forth above provides that the annual certification must be submitted no later than July 1 of each year.

Recommendation # 2:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Section 10-4-633, C.R.S. In the event the Company is unable to provide such documentation, it should be required to provide evidence to the Division of Insurance that it has reviewed its procedure for filing the annual certifications and implemented necessary changes to ensure compliance with Colorado insurance law.

CLAIMS PRACTICES

Issue C: Failure, in some cases, to handle Private Passenger Automobile claims properly.

Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices, provides, in part:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance:

(h) Unfair claim settlement practices: Committing or performing, either in willful violation of this part 11 or with such frequency as to indicate a tendency to engage in a general business practice, any of the following:

(VI) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear;

The following chart illustrates the significance of error versus the population and sample examined:

Private Passenger Automobile Paid Claims

Population	Sample Size	Number of Exceptions	Percentage to Sample
1156	50	6	12%

An examination of fifty (50) paid Automobile claim files, representing 4% of all paid claim files handled by the Company during the examination period, showed six (6) exceptions (12% of the sample) wherein the Company failed to handle Automobile claims properly as required by Colorado insurance law. All of the instances in this issue involved overpayments; therefore no further action as to reimbursement was applicable.

The following table further defines the incidence of error for this issue:

Description
Miscalculation in the total loss work sheet resulting in an overpayment of \$45.30.
Overpayment of \$89.68, due to sales tax paid on owner retained salvage.
Overpayment of \$100.00 resulting from miscalculation of the applicable deductible.
Overpayment of \$250 based on miscalculation of applicable deductible.
Overpayment of \$85.94 by including sales tax on owner retained salvage.
Overpayment of Sales tax of \$246.42 by including sales tax on owner retained salvage.

Recommendation # 3:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Sections 10-3-1104, C.R.S. In the event the Company is unable to provide such documentation, it should be required to provide evidence to the Division of Insurance that it has reviewed its claims handling practices and implemented necessary procedural changes in order to ensure compliance with the Colorado insurance law.

Summary of Recommendations*Encompass Insurance Company Of America*

<u>ISSUE</u>	<u>REC #</u>	<u>CF</u>	<u>PAGE</u>
Company Operations and Management			
A: Failure, in some cases, to provide all surcharge notices requested in order to facilitate the review of surcharged policies.	1	CF5A	17
B: Delay in submitting the 2004 annual certification of forms to the Division of Insurance	2	CF2A	18
Claims			
C: Failure in some cases, to handle Private Passenger Automobile claims properly.	3	CF10A	20

Independent Market Conduct Examiners

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Participated in this examination and in the preparation of this report